No. 22217

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

HOLLYWOOD NATIONAL BANK,

Appellant,

vs.

A. J. BUHR, TRUSTEE,

Appellee.

APPELLEE'S BRIEF.

C. E. H. McDONNELL and
GEORGE T. GOGGIN,
By C. E. H. McDONNELL,
2333 Beverly Boulevard,
Los Angeles, Calif. 90057,
Attorneys for Appellee.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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APPELLEE'S BRIEF.

Statement of the Case.

These proceedings began when A. J. Bumb, Trustee in the Chapter XII proceedings of Louis M. Rubin, filed his "Application for Order to Show Cause for Damages for Wrongful Close of Escrow" on June 10, 1966 [R-1], in which he sought to have the Referee in Bankruptcy determine the damage to the debtor estate for the alleged wrongful closing of two escrows. All of the respondents, Hollywood National Bank, Fleming Brokerage Company and San Ysidro Ranch Corporation, appeared specially, contested jurisdiction. These motions to dismiss were overruled by the Referee on June 29, 1966, in his "Order Denying Motions to Dismiss" [R-46]. All of the respondents, including the appellant here, filed Petitions for Review [R-48]. After hearing, the District Court denied the Petitions for Re-

view and remanded the matter for further proceedings on March 23, 1967 [R-76]. The appellant here, alone, thereupon filed its Notice of Appeal [R-79].

Without contest, at and after the commencement of the debtor proceedings, the appellee, as Trustee in the Chapter XII proceedings, held title to and was in possession of two apartment complexes located in Los Angeles County and commonly known and referred to as "Sycamore Manor" and "Mountain View Manor."

The Trustee undertook to sell, pursuant to an order of Court, Sycamore Manor and Mountain View Manor. As admitted in the opening brief for appellant, to complete the sale two escrows were opened by the Trustee at the appellant Bank. The respondent Trustee contends that the escrows were closed by appellant and deeds to the respective properties delivered by appellant without authority and in violation of the escrow instructions, all to the damage of this estate in an alleged amount of $81,610.22.

Question Presented.

Although there are multiple specifications of errors on which the appellant here relies, it is submitted that they may all be summarized and considered as involving a single issue:

Is an agent of the Trustee who takes property of the bankruptcy estate from the custody of the Trustee and conveys it to a third party within the summary jurisdiction of the Bankruptcy Court?

Summary of Argument.

I.

Appellant Bank was the agent of the Trustee.

II.

Agents have a fiduciary relationship to their principals.

III.

Where property is once in the possession of a bankruptcy estate, the Court acquires jurisdiction over it.

IV.

Jurisdiction over property once in the hands of a bankruptcy estate extends to those who by their acts deprive the bankruptcy estate thereof.

ARGUMENT.

I.

Appellant Bank Was the Agent of the Trustee.

An escrow holder is the agent of the parties to the escrow and is bound to comply strictly with the escrow instructions in the State of California. *Dawson v. Bank of America,* 100 Cal. App. 2d 305, 223 P. 2d 280.

An escrow holder is a depository who is charged with the duty of obeying the instructions of the parties as to the property deposited with him, and for violation of this duty is liable in damages to the party injured. *Trask v. Garza,* 51 Cal. App. 739, 197 Pac. 807; *French v. Orange County Inv. Corp.,* 125 Cal. App. 587, 13 P. 2d 1046.

II.

Agents Have a Fiduciary Relationship to Their Principals.

In California the agent bears to his principal a fiduciary relationship, *Darrow v. Klein & Co., Inc.,* 111 Cal. App. 310, 295 Pac. 566; *Lawrence v. Tye,* 46 Cal. App. 2d 514, 116 P. 2d 180.

The duty of an agent to his principal in California is well summarized in 2 Cal. Jur. 2d §104 (pp. 771 and 772) in the following language:

> "In acting for his principal, an agent is bound to the same standards of conduct—of undivided service and loyalty—of integrity and good faith—as is a trustee; and violation of the agent's trust is subject to the same punitory consequences as are provided for a disloyal or recreant trustee. * * * a violation of duty on the part of a trustee is treated as a fraud upon the beneficiary, and a violation of duty on the part of an agent should be treated in the same manner."

III.

Where Property Is Once in the Possession of a Bankruptcy Estate, the Court Acquires Jurisdiction Over It.

Appellant admits in its brief (p. 8) the well-recognized relationship of bankruptcy jurisdiction to possession, actual or constructive, over the *res. Collier,* 14th Ed., §23.05, page 467, puts it this way:

> "The power of the bankruptcy court to proceed summarily as to controversies over property rests largely * * * upon whether or not the subject matter of the controversy is in its possession, either actually or constructively." (Citing many cases.)

In this case, there is no question whatsoever that at one time the Bankruptcy Court had full jurisdiction over Sycamore Manor and Mountain View Manor — the Trustee was operating the apartments under Court order. The Trustee eventually undertook to sell the debtor estate's interests in the two properties to Fleming Brokerage Company and San Ysidro Ranch Corporation through the appellant escrow holder.

This undenied factor of possession distinguishes the matter here from all of the cases on which the appellant seeks to rely. In every instance, they present factual situations where property was at and before the commencement of the bankruptcy proceedings in the hands of third parties and the bankruptcy estate seeks to reach that property.

Consider the situation in *In re Spur Fuel Oil Sales Corp.* (E.D.N.Y. 1962), 204 F. Supp. 696. In this case, prior to the commencement of the bankruptcy proceedings, there had been a general assignment for ben-

efit of creditors. Under that general assignment and prior to the commencement of the bankruptcy proceedings on February 19, 1962, Lawrence J. Bennett, Inc., purchased certain items of personal property and then delivered them to a third party. The trustee in bankruptcy attempted to reach the property in the hands of the third party. It will be noted that the Court specifically says at page 699 of 204 F. Supp., the Court has no jurisdiction because there was no possession of the property on the date of the commencement of bankruptcy.

Next consider the well-known case cited by appellant of *Suhl v. Bumb* (C.A. 9th, 1965), 348 F. 2d 869, cert. denied, 382 U.S. 938, 86 S. Ct. 388, 15 L. Ed. 2d 349. In this case, A. J. Bumb, as the Receiver for Security Currency Services, Ltd., sought and obtained an order from the Bankruptcy Court whereby one Suhl, his mother, Wherman, and their wholly-owned corporation, American Security Currency, Ltd., were determined to be the *alter egos* of the debtor estate and therefore all of their assets were subjected to the jurisdiction of the Bankruptcy Court and ordered to be turned over. The Court quite properly rejected jurisdiction in this instance because *there never was any possession of any of these assets at the time of the commencement of the bankruptcy or at any time thereafter.*

In *Burton Coal Co. v. Franklin Coal Co.* (C.A. 8th, 1933), 67 F. 2d 796, we have an instance where there is not even a question of property rights presented. In this instance, a surplus had developed in a bankruptcy estate and one of its creditors, who had failed to file a claim within the time then provided by the Bank-

ruptcy Act, sought to reach that surplus. This right was denied. Be it noted, that this case in 1933 was before the adoption of the Chandler Act in 1938, which generally revised the bankruptcy law pertaining to the position of creditors who had failed to file claims within the six months' period provided by the Bankruptcy Act. This case is, of course, no assistance whatsoever in the instant matter because it does not represent a situation where the Trustee is attempting to recover property from a third party.

Next consider *In re Houston Seed Co., Inc.* (N.D. Ala., 1954), 122 F. Supp. 340. In this case, the President and Secretary-Treasurer of the bankrupt filed claims to which the Trustee filed objections, asserting counterclaims for fraud, deceit, breach of fiduciary duty. The Trustee contended that by filing the claim there had been a consent to jurisdiction. The District Judge concluded that Bankruptcy Act §23 operated in Alabama, at least, so that filing a claim did not submit the claimant to the jurisdiction of the Court. This again does not present any useful fact situation for our problem here. Furthermore, the rule enunciated in 1954 in Alabama has been rejected in practically all of the circuits, including the Ninth Circuit, see *Peters v. Lines* (C.A. 9th, 1960), 275 F. 2d 919.

The factual situation in *In re Eakin* (C.A. 2nd, 1946), 154 F. 2d 717, is likewise of no assistance to us in this matter. In that case, there had been a deposit in a bank at the time of the filing of bankruptcy. The bank, assuming that the funds were trust funds, permitted the bankrupt to withdraw them. The Trustee, later on, brought a turnover order against the bank to

require the delivery of the funds. It will be noted that they were at all times either in the bank's possession or in the possession of third parties. The Court rejected the Trustee's action on the grounds that if they were trust funds, they were not part of the bankrupt estate, or if they were not trust funds, the bank had a valid setoff and, therefore, there was no possession in the estate.

Appellant also cites *Morrison v. Bay Parkway National Bank* (C.A. 2d, 1932), 60 F. 2d 41, cert. dis., 296 U.S. 669, 57 S. Ct. 756, 89 L. Ed. 2008. This is an instance of where a judgment for a preference had been obtained against one bank who had sold out to another. Without belaboring the facts further, be it noted that the assets involved were never in the possession of the Bankruptcy Court at any time and the case deals entirely with the rights of the transferee bank in the *plenary* action instituted by the bankruptcy Trustee.

The case of *Lowenstein v. Reikes* (C.A. 2d, 1931), 54 F. 2d 481, cert. den., 285 U.S. 539, 52 S. Ct. 311, 76 L. Ed. 932, is of little assistance to us here. This is a voidable preference action where a question was presented as to whether or not a notice of appeal was timely: It would have been timely if these were plenary actions; it would not have been timely if they were summary bankruptcy proceedings. Be it noted that the property was never in the possession of the Bankruptcy Court.

Finally consider *Bardes v. First National Bank of Hawarden* (1900), 178 U.S. 524, 20 S. Ct. 1000, 44 L. Ed. 1175. This is an action by Bardes, as the Trustee, to set aside a voidable preference. The case clearly

enunciates that which is the general rule, namely, that Bankruptcy Act §2a(7) incorporates, at least to an extent, and is governed by Bankruptcy Act §23.

IV.

Jurisdiction Over Property Once in the Hands of a Bankruptcy Estate Extends to Those Who by Their Acts Deprive the Bankruptcy Estate Thereof.

Sycamore Manor and Mountain View Manor were in the possession of the Bankruptcy Court. The ability to convey those properties was placed in the hands of appellant, an agent of the Trustee. The appellant wrongfully allowed third parties to obtain title and possession of Sycamore Manor and Mountain View Manor. Appellant now comes to this Court and insists that despite its agency relationship, despite having breached its duty to the Trustee, the loss of possession occasioned by its act deprived the Bankruptcy Court of jurisdiction. Appellee insists that both by reason and the law this is not the case.

The general rule has been set forth in *Collier,* 14th Ed., §23.05, pages 480 and 481:

> "It has been said that 'Constructive possession occurs where the property (1) is in the physical possession of the bankrupt at the time of the filing of the petition but is not delivered by him to the receiver or trustee, or (2) *is delivered to the receiver or the trustee but is thereafter wrongfully withdrawn from his custody,* or (3) is in the hands of the bankrupt's bailee or agent, or (4) is held by some other person who makes no claim to it, or (5) is held by one who makes a claim which is not substantial and is colorable only.'" (Emphasis supplied.)

The District Court of New York in *Matter of Retail Stores Delivery Corp.,* 5 F. Supp. 892, summarizes the pertinent rule in the following language:

> "It is also the established rule that jurisdiction once attaching is not lost by the fact that later on possession of the property passes to strangers without order of the court and while the bankruptcy proceeding is still active. It is immaterial whether the change of possession has come about through voluntary transfer by the bankrupt or his agent, seizure by officers of state courts, or unauthorized surrender by officers of the bankruptcy court; the jurisdiction continues and the court has summary power to order a return of the property. * * * Where property once in the custody of the bankruptcy court is removed, return of the property may be summarily ordered without a trial of title; that issue may be tried later when and if the alleged owner seeks to reclaim."

The earliest case that appellee has been able to discover on this matter is *White v. Schlorb,* 178 U.S. 542, 20 S. Ct. 1007, 44 L. Ed. 1183. In this case, on September 13, 1899, a voluntary petition in bankruptcy was filed. On the same day the Referee ordered the store locked to protect its contents. On September 21, 1899, the Cogans began an action in the Wisconsin State Court to replevy certain of the personal property which was locked in the store. In this action the Sheriff broke into the store and took possession before the Trustee could be elected. Upon his election, the Trustee instituted a petition for an order to show cause to require the return of the property from the Sheriff, who then made a motion to dismiss on the grounds of no jurisdiction

because the property was not any longer in possession of the Bankruptcy Court and was held under an adverse claim. The Supreme Court determined that once the property was in the custody of the Bankruptcy Court, it could not be taken therefrom upon process in the State Court without the authority of the bankruptcy Judge. The Court then, at page 548 of 178 U.S., said as follows:

> "* * * the judge of the court of bankruptcy was authorized to compel persons who had forcibly and unlawfully seized and taken out of judicial custody of that court property which had lawfully come into its possession as part of the bankrupt's property, to restore that property to its custody; * * *."

From these cases, it will be seen that there is a clear right to recover property which has been taken from the possession of the Bankruptcy Court: But what of the situation where the property cannot be returned?

The leading case in this area appears to be *Burnham v. Todd* (C.A. 5th, 1943), 139 F. 2d 338. In this case, a bankruptcy Trustee, after many years of administering certain oil leases under the jurisdiction of the Bankruptcy Court, discovered that Burnham and Johnston had removed from under the oil leases approximately 55,000 barrels of oil of a value of about $1.15 per barrel. He instituted a summary proceeding in the Bankruptcy Court against Burnham and Johnston to require them to pay this amount to the bankruptcy estate. Burnham and Johnston contended that the action would not lie against them because they were entitled to a plenary suit. In dealing with this problem the Court said, at page 341 of 139 F. 2d the following:

> "The prayer is for a summary restoration of the value of the oil. It is common knowledge, and the

> evident assumption of the petition, that oil at the wells is soon mingled with other oil and disposed of, so that identification and restoration of the oil itself would after the lapse of years be impossible. When property taken from the custody of the court is put beyond the possibility of return, the taker can be required to make reparation by paying its value instead. [Citing cases] The object of such a proceeding is not to try the title to the property, or to adjudicate any interest in it, but to maintain the integrity of the court's custody and its right to administer it. * * * The oil here was in the actual custody of the court, and Johnston and Burnham make no claim of right to it; they only say they did not take it. If they now had it, without question they might be required summarily to turn it over. Since they have done away with it, with equal certainty they may be required to substitute it with money."

It is submitted that this case is, at least in theory, almost precisely on all fours with the instant problem. An inspection of the Trustee's Application will reveal that the following is the generally contended situation: That the parcels of property involved were subject to an institutional first deed of trust and taxes; that the terms of the sale called for the first deed of trust to be made current and taxes paid; that the escrow was closed by appellant without the performance of this consideration and that therefore the properties were available to be foreclosed by the institutional lender. In California, it now appears to be the rule that where a bona fide purchaser obtains the property which was improperly delivered by the escrow holder, that the

original owner may not recover the property, see *Phelps v. American Mortgage Co.,* 40 Cal. App. 2d 361, 104 P. 2d 880. Thus it would appear, that the actions of the respondents in the order to show cause proceeding have placed Sycamore Manor and Mountain View Manor beyond the reach of the Trustee in the debtor proceedings. Therefore, applying the rule of the *Burnham* case, it would appear that there was clearly jurisdiction in the Bankruptcy Court to require appellant, and also the buyers, Fleming Brokerage Company and San Ysidro Ranch Corporation, to respond in damages to the Court.

A similar result is reached in the case of *In re Mason C. Jones Co.* (N.D. Ohio E.D., 1953), 109 F. Supp. 843. In this case, the Trustee took possession of certain premises of the bankrupt and changed the locks. One Arment broke into the premises and took out chattels which he claimed to belong to him. The Referee found summary jurisdiction to require the payment of the value of the chattels, saying at page 847 of 109 F. Supp., the following:

> "* * * the petitioner's careless disregard of the authority and possession of the bankruptcy court, coupled with his failure to account for assets on the premises and those which he admitted he removed places upon him the responsibility of producing such property *or its approximate value.*" (Emphasis supplied.)

There is no point in belaboring the matter further: The cases and the authorities seem to be in complete accord that where, as here, property has been in the possession of a bankruptcy estate and has been, by some third party, removed from that possession, the

Bankruptcy Court has jurisdiction to either compel its return or, if that proves to be impossible, to fix a monetary sum of damages for the property which has thus been lost. Certainly, this general rule should be even more reinforced where, as here, the person who removed the property from the possession and control of the Bankruptcy Court is an agent bearing a fiduciary duty to the bankruptcy Trustee.

Conclusion.

The Referee's Order sustaining his jurisdiction was in all respects proper, and the Order of the District Court denying the Petition for Review and remanding for further hearing should be sustained and the matter should be remanded to the Referee for trial upon the merits.

Respectfully submitted,

C. E. H. McDonnell and
George T. Goggin,
By C. E. H. McDonnell,
Attorneys for Appellee.

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit and that, in my opinion, the foregoing brief is in full compliance with those rules.

C. E. H. McDonnell